OUR FIRM

Boyd Watterson Asset Management, LLC is an SEC-registered investment advisory firm with $8.1 billion of assets under management. For more than 80 years, we have successfully managed a broad range of fixed income, real estate, and equity strategies for institutions and individuals alike.

With a singular focus on the management of money and a dedication to the satisfaction of our clients' expectations, we offer the benefits of a boutique firm but with the resources usually attributable to a much larger asset management firm.

Please visit our website, ***www.boydwatterson.com***, for information about Boyd Watterson's investment strategies, insights, philosophy, and people.

Looking for a new perspective on fixed income and real estate markets?

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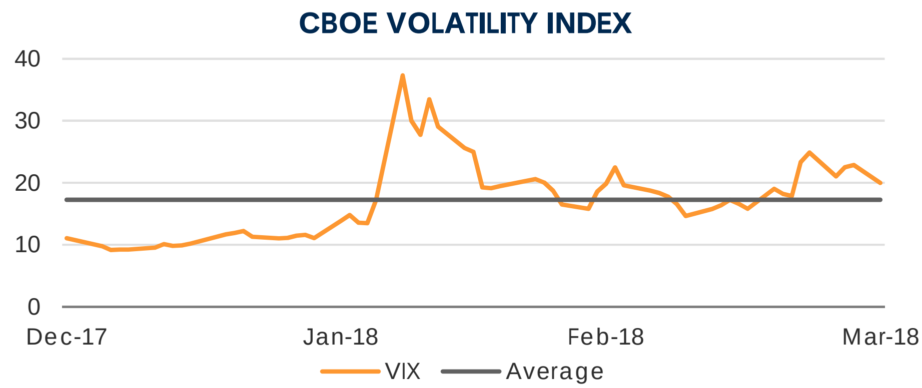
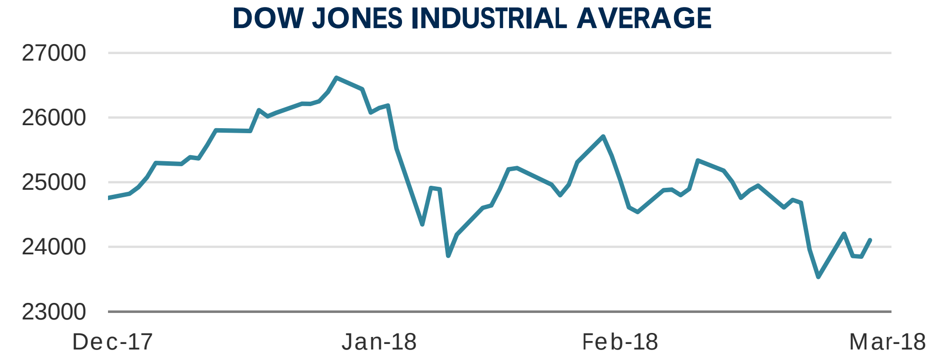
THE MACRO VIEW: MORE GROWTH BUT MORE VOLATILITY

At the end of 2017, our general outlook projected continued moderately paced growth of the economy, but a return to more normalized levels of volatility. The spike in equity volatility that took place in February and March was not really a tremendous surprise - but it was a clear reminder of what can happen when market mentality changes from investor optimism to investor pessimism. Although we think investors were poised for interest rates to rise in an orderly fashion in 2018, February was clearly illustrative of a higher level of investor anxiety sparked by the fear that a strong economy coupled with a tight labor market was leading to rising wage growth. Rising wage growth could in turn lead to higher inflation fears that would likely be met by a more hawkish Fed response, resulting ultimately in slower economic growth.



Source: Bloomberg. Data through March 31, 2018.

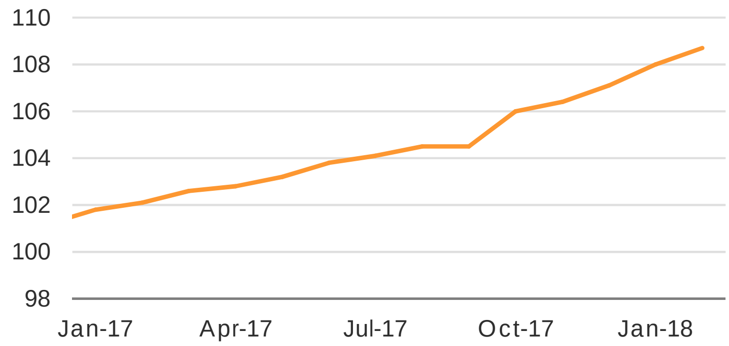
The volatility we saw in March was different, sparked by geopolitical fears stemming from tariffs on steel and aluminum and the potential for trade wars, predominantly with China. Tariffs and trade wars don't sit very well with the risk markets, as reflected in the performance of the Dow Jones Industrial Index, which declined 3.7% in the month of March. We sense headlines over the next few months will be worse than the actual outcome – but it is a noteworthy event that merits watching as it unfolds.



Source: Bloomberg. Data through March 31, 2018.

Despite this heightened ambiguity in markets and the fits and starts that we think are likely throughout 2018, we see moderate – not spiking – inflation and strong fundamentals in corporate earnings that will continue pushing the US economy to expand at a rate of about 2.7% in 2018. In short, we see a consistently advancing US Leading Economic Index along with a flattening Treasury yield curve (but one that remains positively sloped near-term), high consumer confidence and a strong labor market pointing to extension of the current moderate growth environment.

COMPOSITE INDEX OF 10 LEADING INDICATORS



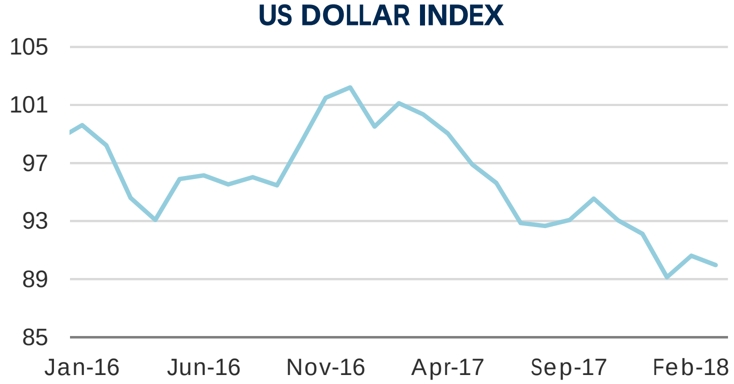
Source: The Conference Board. Data through February 28, 2018.

THE FED, INTEREST RATES AND INFLATION: "THREADING THE NEEDLE"

During the first quarter, new Fed Chairman, Jerome Powell, chaired his first FOMC meeting. There was a high degree of market uncertainty as to how the new Administration's appointee would manage inflation and meet the challenge of the post crisis monetary policy normalizations. The new regime was upbeat on the economic landscape at their March meeting, expressing that the economy had strengthened in recent months, a prompt for upgrading the 2018 growth projection from 2.5% to 2.7% and initiating the first of three anticipated 25 basis point rate hikes for the year.

Despite the changing of the guard and a slightly more hawkish Fed in Powell than prior Fed Chair Janet Yellen, we think their stance on post crisis policy normalizations is not materially different and will largely remain consistent for now – and there is likely some relief in that for markets. The Fed appears on track to continue both slowly boosting rates and reducing the central bank's balance sheet from post crisis levels. In our opinion, based on the steady weakening of the US dollar since 2016 in the face of six prior rate hikes, we believe that economic growth can sustain and continue edging up with the Fed's current policy of continued, gradual rate hikes.

US DOLLAR INDEX



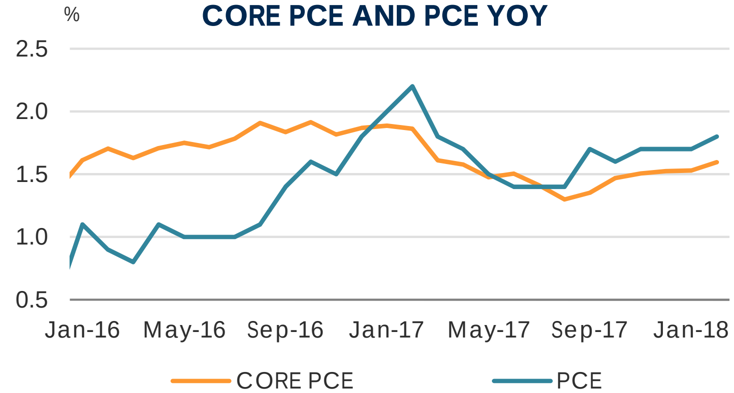
Source: Bloomberg. Data through March 31, 2018.

In terms of interest rates and Fed moves in the future, there was much concern by some pundits of a potential fourth rate hike in 2018, which would put additional pressure on growth, earnings and raise prices on credit products, like home mortgages. Barring unforeseen disruptors – like a trade war – we think it will remain a total of three hikes for 2018, moving the fed funds rate to roughly 2.1% by the end of 2018. The Fed made some changes to their forecast following their meeting in March:

- Their projected hikes in 2019 increased from two to three with a year-end rate projection of 2.9%, up from 2.7%
- Their outlook for 2018 inflation moved from 1.7% to 1.9%, and 2019 slightly increased from 2.0 to 2.1%.

Overall, we expect the result of the Fed's moves to continue flattening the yield curve, but don't believe the curve will land inverted this year, a typical signal of recession. On the inflation front - a topic of great concern and laser focus by investors - the Core PCE, the Fed's benchmark for tracking inflation, is currently running at only about 1.5%, well below the Fed target of 2.0%.

CORE PCE AND PCE YOY



Source: Interactive Data Corporation. Data through February 28, 2018.

CAVEATS: GEOPOLITICAL INSTABILITY IS THE WILDCARD

Despite thinking that the actual outcome from the recent trade war news will not be as bad as the tweets and headlines, geopolitical event-driven risks is one of our concerns for 2018. Based on the numerous high-level staffing changes at the White House in March alone, including Secretary of State and the President's National Security Advisor, coupled with a hard-nosed and protectionist-type negotiating style, it seems a course of unpredictability has been set with other foreign leaders. These new appointments add further uncertainty to the horizon and could undoubtedly add to market volatility near-term.

But more impactful to both equity and bond markets is the Trump Administration's stance on trade policies. Although Canada, Mexico and handful of other key US allies have been exempted from the recent tariffs placed on steel and aluminum, the market is concerned that the new tariffs will lead to higher prices and therefore, higher inflation which could increase the chance of a recession. It is clear to us that trade wars and tariffs are not good for the consumer or the overall growth rate of an economy and therefore, not good for the performance of risk assets.

CONCLUSION: OPTIMISM WITH AN INCREASINGLY DEFENSIVE POSTURE

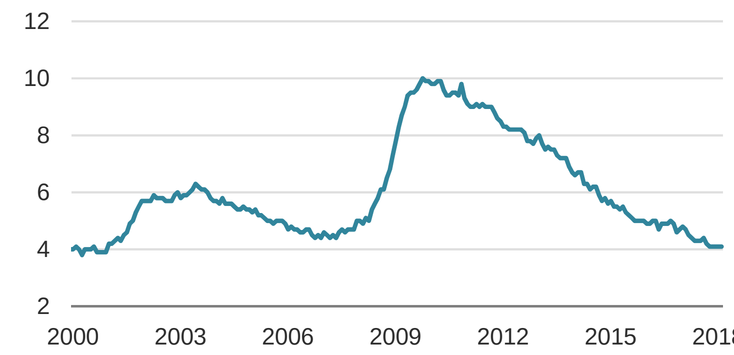
Our goal has always been - and remains today - to be an income provider, generating attractive risk adjusted returns, while providing downside protection. We see the current geopolitical landscape as a source of downside risk that warrants a more defensive strategy for our client's assets. That said, despite increased volatility, our outlook generally remains positive - forecasting the US economy to continue its undulating growth into 2019, but the landscape and profile in terms of price, returns and potential external disruptions could be more challenging than prior years. The way we see things, the real navigational challenge in the current environment is determining if the strong fundamental backdrop of economic growth and modest inflation will win out versus the declining technical backdrop.

THE OVERVIEW BY MARKET

FIXED INCOME

The Federal Reserve has certainly been a focal point and weighed heavy on bond investors this quarter. And from a consumer perspective, they have every right to be concerned - higher rates mean a higher cost of servicing existing debt. The early year inflation scare by investors in February was clearly driven by the expectation that wage growth and a tight labor market was finally going to push up the rate of inflation and force the Fed to take a more hawkish stance. But, from what we see, inflation continues to remain well under control. We are sticking to our forecast of three Fed rate hikes in 2018 and believe they have largely been priced into the market. Supporting our forecast are indicators such as the PCE which is running at about 1.5%, well below the 1.9% inflation expectation targeted by the Fed for 2018. We further think that strong momentum in manufacturing, housing and employment will continue to be supportive of growth during 2018 and into 2019.

CIVILIAN UNEMPLOYMENT RATE



Source: The Conference Board. Data through February 28, 2018.

In terms of Treasury yields over the quarter, we believe a continuing rise in short rates has created some attractive buying opportunities, and as such - we are carefully monitoring the duration of portfolios to potentially capture some of these newer and pending prospects that we see unfolding over the next several quarters. During the quarter:

- 2-year Treasuries started at 1.92% and ended at 2.27%
- 10-year Treasuries started the quarter at 2.41% and got as high as 2.95% over the quarter but ended March at 2.74%
- The spread between the 2- and 10-year Treasury at the beginning of the quarter was a mere 54 basis points and has continued to hover in that range through quarter end at 3/31

Overall, we see short term rates rising along with the fed funds rate, while we see long term rates remaining range-bound between 2.25%-3.25% and held in check by modest inflation.

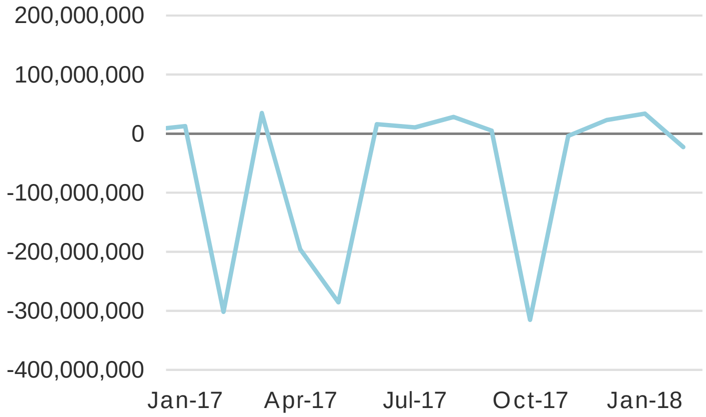
2-YEAR AND 10-YEAR TREASURY SPREAD

Source: Bloomberg. Data through March 31, 2018.

In terms of risk assets, returns during 2017 were positively impacted by strong technicals – a high level of corporate and foreign demand for US assets - and fundamentals. Going forward, we believe fundamentals will remain supportive of risk assets, however, we are already seeing definitive signs that the technical backdrop is weakening. Many corporations are reducing their holdings of US corporate bonds, especially in the 1 – 5-year portion of the curve. This "new" supply to the market, coupled with the Fed reducing its balance sheet has caused risk assets to underperform US Treasuries thus far in 2018. We believe higher interest rates, strong fundamentals and more attractively priced risk assets should lead to better performance as the year progresses.

Within risk assets, high yield securities also performed well in 2017, generating a return of just over 6.0% (as measured by the Bank of America Merrill Lynch High Yield Master Index). The sector benefitted from robust corporate earnings growth and strong demand from domestic and international buyers in search of higher-yielding securities. We think some of that will change in 2018. In fact, demand for high yield reversed course in the first quarter, evidenced by a return to outflows during the first quarter in the high yield mutual fund category.

HIGH YIELD MUTUAL FUND CASH FLOWS



Source: Morningstar Direct. Data through March 31, 2018.

Generally speaking, we anticipate returns in the high yield arena to moderate during 2018, which could result in overall lower fixed income returns. Our projection is based on our belief that the Fed will achieve its target of raising the fed funds rate three times this year, with the risk of an additional hike greater than the risk of fewer hikes. We also expect inflation to gradually rise to 2.0% as a tight labor market eventually leads to higher wages and an expanding global economy leads to higher commodity prices.

Performance for periods ending March 31, 2018

	QTD	1-Yr	3-Yr	5-Yr	10-Yr
2-Year Treasury	-0.15	-0.20	0.22	0.42	1.12
10-Year Treasury	-2.40	-1.15	-0.73	0.55	3.29
Bloomberg Barclays Aggregate	-1.46	1.20	1.20	1.83	3.63
Corporate Investment Grade	-2.21	2.67	2.35	3.04	5.36
Corporate High Yield	-0.96	3.65	5.16	4.99	8.04
Leveraged Loans	1.58	4.64	7.16	4.33	4.17
Mortgage Backed Securities	-1.23	0.72	1.10	1.78	3.45
S&P 500	-0.76	13.99	10.78	13.31	9.49
MSCI EAFE	-1.53	14.80	5.55	6.49	2.74

Source: Interactive Data, Credit Suisse, Bank of America/Merrill Lynch/Bloomberg. Data through March 31, 2018.

In terms of positioning, our fixed income portfolios have been:

- Consistently short of the benchmark duration
- Overweight TIPs and floating rate notes that reset at frequent intervals as a built-in insurance policy for inflationary spikes (TIPs) or positioning portfolios to rates rises (Floating Rates)
- Overweight risk assets, but we are moving a bit more defensively

With the prospect of ongoing volatility remaining high, we have been:

- Focused on credit quality
- Companies that in our view have low betas
- Solid histories of stable financing
- Strong cash flow and earnings potential that we believe can effectively operate throughout a market cycle

REAL ESTATE

Although 2017 proved another good year for the real estate sector and fundamentals remain strong, we see a few growing headwinds that we are tracking as we move through 2018:

- Interest rates look increasingly likely to rise (negative for income returns)
- Pricing across asset classes and types has remained at elevated levels
- New acquisitions with attractive risk/return characteristics more difficult to find

Still – in general - we see more positives than negatives:

- Occupancies are high
- Transaction volumes are above historical averages (an indicator of continued investor interest)
- Record levels of uninvested but available capital held by funds

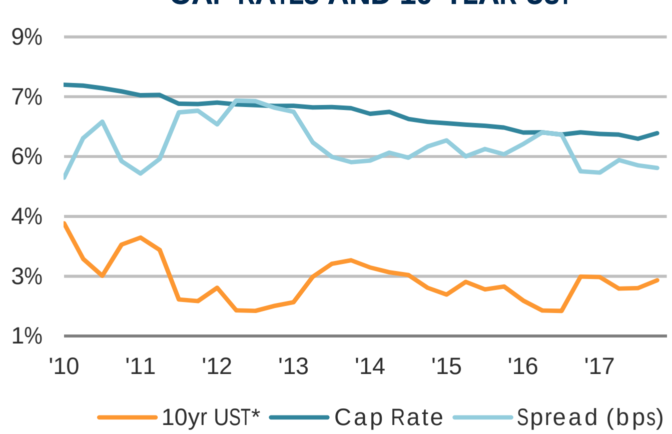
All of these suggest that there will not be a significant drop in asset values.

At a sector level, we expect to see slower rental growth in office and multi-family in coming years, as increasing supply in these sectors offsets fairly strong demand. Retail continues to be negatively impacted by store closings, particularly in the big box and lower-quality mall space - which will negatively impact rental rates. Many landlords in the retail sector have been able to backfill lost anchor store tenants with experience-based retail that has been less impacted by online retail. Even some online retailers have continued to grow through the creation of live store fronts in key urban areas, though we don't see there being ample enough demand in that subset of tenants to offset other declines within the retail rental market. Industrial real estate is one outlying sector with a strong outlook for rental growth and demand as Amazon and last-mile distributors continue to require additional warehouse space.

Based on the above factors and an expected rise in interest rates, we think further cap rate compression is unlikely. Given the amount of dry powder available to investors, healthy balance sheets and real estate fundamentals, as well as beneficial tax reform, we would expect cap rates to remain fairly stable with the spread between cap rates and interest rates to shrink rather than moving in lockstep up. We are already seeing evidence of this trend in the numbers with spreads narrowing to their tightest since 2011 - approximately 375 bps.

Going forward and based on the performance trends we are seeing, we believe the overall slowing of returns in the sector will be driven by continued lower appreciation returns in the coming years of 0.0%–2.0% annually and income returns in the 4.0%–5.0% range, with overall returns averaging 5.0%-7.0% annually (net of fees) for the next three years. Going forward, we see high-quality income generation—and not capital appreciation—being the primary contributor to real estate returns over the next few years. In our view, the macro changes that are evolving represent more of a shift to less robust returns rather than an actual downturn. We have already seen an extended real estate cycle thanks to a strong economy and restrained lending which has held back supply growth. We see few signs of distress in most markets and we expect for the real estate cycle to stay in an extended peak for at least the next 18 months.

CAP RATES AND 10-YEAR UST



Source: Real Capital Analytics, Federal Reserve. Data through December 31, 2017.

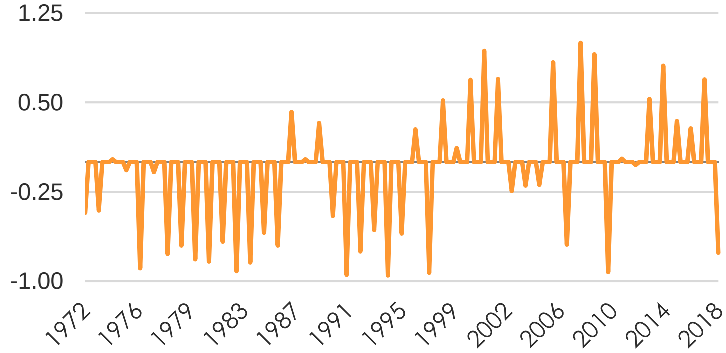
EQUITIES: POSITIVE RETURNS BUT A MORE RICKETY RIDE

It has clearly been an event filled quarter for equity markets, with the S&P having its first negative quarterly return since third quarter of 2015. The US stock market has endured bouts of volatility and the first 10% drawdown since early 2016. Small cap US equities outperformed large cap, with the Russell 2000 beating the Russell Top 200 by 70 basis points. Growth has been in a long-term uptrend relative to value since the end of 2006 and continued to outperform along the cap spectrum during the first quarter. Although volatility over the quarter has unnerved investors, we see synchronized global growth coupled with accommodative central bank policies as supportive of global equity markets during 2018.

In the US specifically, we think fundamentals for growth and corporate earnings prospects remain strong, providing solid evidence to us that the US equity market will continue to boast positive returns during 2018. Further, we see the simulative tax reform package recently put in place by the White House as driving additional potential for earnings growth and share prices which further support positive US equity market returns in 2018. As noted earlier, we think some of the declines in valuations that likely occur over 2018 are in fact *healthy*, removing market overconfidence and normalizing how equity and bond markets move, typically inversely. In our opinion, any corrective measure to valuations that is short of a 20% decline (a benchmark for recession) we believe can likely be absorbed by the market while still providing positive returns.

ROLLING ONE-YEAR CORRELATION

10-Year Treasury and S&P 500 Index



Source: Bloomberg. Data through March 31, 2018.

For the duration of 2018, we will keep our eyes focused on the fundamentals, with a watchful stance to monitoring trade policies and the sectors that are most likely affected, such as technology or farming– which could be particularly vulnerable to a trade dispute with China. Albeit unlikely in our view, we haven't lost sight of the impact such an event could have. Using Apple as an example, sources indicate that roughly $1 of every $5 of Apple sales during 2017 came from China, Hong Kong and Taiwan, and that does not account for the high volume of assembly and manufacturing of Apple taking place in Chinese factories that could be subject to tariffs and resulting price increases. Apple and its customers would likely feel the impact.

Further, a hostile trade policy could have the effect of undermining growth of larger, dividend paying US companies. Practically speaking, large US companies often receive a solid portion of their revenues from foreign buyers, making them more vulnerable to damage from any trade war. The way we read the road, no one wins with a trade war and we think both super powers, the US and China, have recognition of that reality. Despite the overheating in the news of trade wars and other geopolitical uncertainties like North Korea, we generally see positive equity outcomes persisting for 2018 along with continued caterpillar- like growth of the economy, but a ricketier ride than prior years.